DOCUMENT RESUME

ED 388 146 HE 028 689

AUTHOR Jones, Dennis P.
TITLE Strategic Budgeting: The Board's Role in Public Colleges and Universities. AGB Occasional Paper Series. AGB Occasional Paper No. 28.
INSTITUTION Association of Governing Boards of Universities and Colleges, Washington, D.C.
PUB DATE 95
NOTE 22p.; Publication was supported by a grant from the Robert W. Woodruff foundation.
AVAILABLE FROM Association of Governing Boards, 1 Dupont Circle, N.W., Suite 400, Washington, DC 20036 ($5.95).
PUB TYPE Reports - Descriptive (141)

EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS *Budgeting; Educational Finance; Governing Boards; Higher Education; Long Range Planning; *Public Colleges; *Strategic Planning

ABSTRACT

This paper prescribes a significant change in the budgeting practices of most public colleges and universities by urging an approach to budgeting that focuses on the creation and maintenance of institutional assets and the use of mechanisms that reward accomplishment through effective utilization of these assets. This approach contrasts with typical practices that result in an "equitable" allocation of resources or that adjust prior years' budgets for inflation but make no attempts at reallocation. Special characteristics of strategic budgeting include: (1) it provides college and university leaders with a tool for ensuring the long-term adequacy and integrity of institutional assets; and (2) it sets aside a pool of resources each year for the individuals and units that make the most positive contribution to addressing priorities established in the strategic-planning process, that is creating a specific pool of resources to be invested in the institution's future. By requiring a budget structured in a way that expressly recognizes asset maintenance and by establishing guidelines tied to the strategic directions of the institution before the bottom-up processes of building the budget begins, board members can help balance the long-term needs of the institution against the short interests that normally prevail. (Author/JB)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED 388 146

Association of Governing Boards
of Universities and Colleges

Strategic Budgeting: The Board's Role in Public Colleges and Universities

By Dennis P. Jones

AGB OCCASIONAL PAPER No. 28

BEST COPY AVAILABLE

HE 028 689

"PERMISSION TO REPRODUCE THIS MATERIAL HAS BEEN GRANTED BY

AGB

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

☑ This document has been reproduced as received from the person or organization originating it.

☐ Minor changes have been made to improve reproduction quality.

• Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

The AGB Occasional Paper Series addresses current and emerging issues of concern to board members and administrators in the context of their institutional settings. Some titles in the series are commissioned by AGB; others are the work of reputable individuals or groups whose work comes to our attention. This series of publications is intended to inform debate and discussion, not to represent or imply endorsement by the association or its members.

AGB distributes new titles in the Occasional Paper Series as they are published to chief executives and board chairs of member institutions. Additional copies are available at a nominal charge by calling or writing to AGB.

Copyright 1995 Association of Governing Boards of Universities and Colleges, One Dupont Circle, Suite 400, Washington, D.C. 20036. All rights reserved.

Association of Governing Boards
of Universities and Colleges
One Dupont Circle • Suite 400
Washington, D.C. 20036
Tel: 202/296-8400 Fax: 202/223-7053

Executive Summary

This paper prescribes a significant change in the budgeting practices of most public colleges and universities. It describes an approach to budgeting that focuses on the creation and maintenance of institutional assets and the use of mechanisms that reward accomplishment through effective utilization of these assets. This is in contrast to typical practices that result in an "equitable" allocation of resources or that adjust prior years' budgets for inflation but make no attempts at reallocation.

Many institutions do a credible job of strategic planning, but few see the results of these planning efforts translated into institutional action and change. The author argues that this failure of implementation can be ascribed to budget processes that are not designed specifically to carry out planning decisions. The prescription is to adopt a strategic approach to budgeting.

Strategic budgeting has two characteristics of particular note. First, it provides college and university leaders with a tool for ensuring the long-term adequacy and integrity of institutional assets. This responsibility of institutional leadership seldom is recognized in current budgeting practices. Second, a strategic budget structure sets aside a pool of resources each year for the individuals and units that make the most positive contributions to addressing priorities established in the strategic-planning process—there is a specific pool of resources to be invested in the institution's future.

By requiring a budget structured in a way that expressly recognizes asset maintenance and by establishing guidelines tied to the strategic directions of the institution before the bottom-up processes of building the budget begins, board members can help balance the long-term needs of the institution against the short interests that normally prevail. Further, by focusing on strategic issues, board members can become engaged in the budget process around issues that are necessarily within their purview—not at a micro level where decisions are within the legitimate domain of unit heads. By using the structure of the budget to signal a clear sense of direction and by providing visible support for institutional leadership in implementing these directives, board members can make a critically important contribution to the vitality and performance of the institutions for which they ultimately are responsible.

Publication of this paper is made possible by a grant from the Robert W. Woodruff Foundation.

STRATEGIC BUDGETING: THE BOARD'S ROLE IN PUBLIC COLLEGES AND UNIVERSITIES

The budget is the most powerful tool boards can employ to help implement institutional plans and to reward contributions aimed at achieving organizational objectives. It is a mechanism through which positive incentives can be established and creativity unleashed; in contrast, other tools—regulations, procedures, oversight—are uniformly negative and constraining in their influence.

In spite of the budget's central importance to the direction and functioning of any college or university, the board's role in shaping the budget typically is minimal. Most boards are required to approve the budgets for the institutions they govern. Their early involvement usually entails establishing the guidelines for tuition and salary increases. Typically, all the real decisions have been made by the time board sees the budget; its role is limited to final approval.

Although boards are involved considerably in planning the future of the institution, they are detached from the process that implements these plans. Why is this the case? One explanation is that planning tends to be strategic in nature, while the budgeting process characteristically is tactical or operational in its focus. Planning increasingly is directed at institutional issues and priorities and is given its impetus by leadership. It essentially is a top-down process (albeit with involvement of persons at all levels of the organization). On the other hand, budgeting traditionally is a bottom-up process. Requests are initiated at the unit level and work their way up the organizational chain, usually with reductions made at each step of the process. Institutional administrators react to—rather than shape—initiatives that originate at lower levels of the organization. Understandably, these initiatives reflect the priorities of the originating unit and, in the absence of conscious and consistent effort, only accidentally reflect the needs and priorities of the institution.

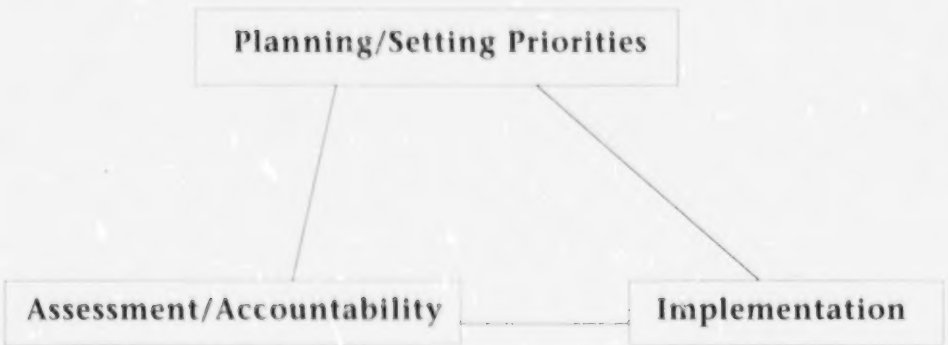
With planning coming from the top down and budgeting from the bottom up, it is little wonder that these processes often pass like ships in the night. Plans are abstractions; budgets—and money—are real. Without intentional connections between the two, the budget (and the unit-level perspectives it reflects) dominates institutional life and behaviors. If institutional priorities are to be pursued and achieved, board members must approach budgeting with a broader, institutional perspective. They must understand "strategic budgeting," and use it effectively.

The Key Concepts

The notion of strategic budgeting is based on a few simple propositions. First, the budget is a key implementation mechanism in the larger scheme of an institution's strategic decision-making activities. (See Figure 1.)

Figure 1

Strategic Decision-Making Activities



Within this framework, it is important to understand that all budgets contain incentives for behavior. In the absence of an explicit and reinforcing connection between the institution's plans, its priorities, and the budget, implicit incentives hold sway. These incentives often work contrary to forces for change and responsiveness to client needs. Connecting the budget to institutional plans and an agenda for change requires institutional leaders to act with specific intent.

Second, institutional leaders are responsible for ensuring that the institution's assets are sufficient, well maintained, appropriate to the institution's mission and planning, and responsive to the needs of key constituents—in the case of public institutions, the state. Also, leaders must ensure that the institution is buffered against unexpected financial changes.

These propositions are straightforward—but when extended into the resource-allocation process, they suggest significant changes to the current way of doing business. Three changes, in particular, are worthy of note. First, strategic budgeting emphasizes long-term shaping and maintenance of the institution's basic asset structure rather

than the short-term economic cost of those assets. It focuses attention broadly on the components of the institution's balance sheet rather than more narrowly on revenues and expenditures. Attending simultaneously to the balance sheet and the profit-and-loss statement is a fundamental principle in the private sector, where positive performance on both fronts is a clear expectation and maximizing short-term profits (or, at least, balancing the books) through actions that diminish an organization's asset base is not acceptable.

However, neglecting the assets of the institution to balance the annual budget is a common practice in higher education. When finances are constrained beyond the norm, colleges and universities systematically disinvest in their assets. They defer maintenance on facilities, postpone replacement of equipment, stop acquiring library books, eliminate sabbaticals and other professional development activities, and cease the systematic development and revision of curricula. These sacrifices of the long-term capacity of the institution are made to maintain stable working conditions, so jobs are not lost, salaries and wages are not diminished, and ways of doing business are not substantially altered.

Strategic budgeting emphasizes long-term shaping and maintenance of the institution's basic asset structure rather than the short-term economic cost of those assets.

Ignoring maintenance of institutional assets to maintain the status quo is reasonable if the financial constraints that engendered this response are short-lived. However, there is considerable evidence that, in most states, higher education institutions will live with scarcity in the future. Limitations on states' abilities (or willingness) to raise revenues—coupled with competing claims on available resources by Medicare, corrections, and K-12 education, and with growing resistance to raising tuition to compensate for shortfalls in state funding—make this condition all but inevitable.

Under such conditions, heed the "First Law of Holes": When you are in one, cease digging. Higher education generally has not heeded this admonition. By avoiding expenditures on asset maintenance for a protracted period, institutional leaders (aided and abetted by government leaders who are willing to let things slide) dig themselves into deeper holes. Neglect is cumulative. There is truth in the advertising line that warns, "Pay me now, or pay me later—but you'll pay me more if you pay me later." Senior administrators and board members must devise an approach to budgeting that reflects their obligation to create and protect an appropriate set of institutional assets. No other group will, or can, assume this responsibility.

The second significant change rests in leaders' obligation to ensure that the institution has basic capacity (assets) and that it applies them support the institution's mission, so no part is ignored and more important, funds are not expended on pursuits that fall outside the mission. There also are more specific requirements: Leaders must explicitly link the budget to the priorities and objectives that emerge from the institution's planning processes and construct the budget to direct attention to the needs of key external clients, most specifically the state.

While the budget must become a principal lever for change, predominant budget practices tend to reinforce the status quo. They simply reflect changes in numbers of students served, salary levels, and prices paid for goods and services—but not changes in institutional priorities or behaviors. This is a recipe for serious problems when the expectations of students and the states are changing, when increasingly insistent calls for accountability are framed in outcomes rather than financial terms, and when the collision of increasing expectations and limited resources fairly scream "no more business as usual." One device for coping with these forces is to set aside a portion of the budget and explicitly designate these funds for activities that help the institution adapt to new circumstances and respond to clients' needs.

One device for coping with major forces for change is to set aside a portion of the budget and explicitly designate these funds for activities that help the institution adapt to new circumstances and respond to clients' needs.

The final requirement of strategic budgeting is less a change in the approach to budgeting and more an expansion of good practice in which some institutions engage. It derives from the imperative leaders have to shield the institution or system from unexpected financial misfortune. As resources get tighter, it is common for institutions to sharpen their pencils and create tighter budgets. They employ perfectly legitimate devices, such as the following:

- Personnel costs are budgeted to allow for vacant positions.
- Revenue estimates are less conservative. In public institutions, this normally takes the form of forecasting higher enrollments and, therefore, tuition revenues, than would have been projected in previous years.
- The "cushion" in the utilities budget is eliminated by betting on average climatic conditions rather than on extreme conditions.

Each of these steps can be justified easily as representing more accurate budgeting. There certainly is nothing wrong with such prac-

tices. However, each such action has the effect of eliminating "slack" in the budget, which becomes good practice only if slack—in the form of a contingency fund—is expressly made a part of the budget.

In the absence of a contingency fund, the institution becomes particularly vulnerable to shifts in financial fortunes: Some portion of state appropriations are rescinded, enrollments are lower than projected, extreme climatic conditions do prevail, and so forth. If there is no such contingency fund available, the pending financial emergency will force short-term actions that fall heavily, perhaps exclusively, on those parts of the budget designed to maintain assets and promote institutional change. Since faculty and other personnel are under contract for the academic year by the time financial problems are discovered, expenditures that sustain the status quo become a first priority. Cuts are made in equipment and library book purchases, renovation of buildings, and in set-aside funds earmarked for professional and curricular development and innovations. Thus, even when the budget is constructed to accommodate the institutionwide responsibilities of senior administrators, inattention to the corporate safety net easily can result in the good plans going awry.

If college and university leaders are responsible for ensuring the long-term adequacy and integrity of institutional assets and are accountable to institutional clients for using those assets effectively, how can they fulfill these obligations? The budget is probably the most potent tool available to them. Thus, a major part of their strategic planning should be to take an active role in shaping the budget and periodically monitoring its implementation. This specifically does *not* mean getting deep into the details of the budget and attempting to micromanage allocations. Such actions interfere with the decision-making authority and responsibilities of managers, breeding resentment of those upon whom the leaders depend for smooth functioning of the enterprise. Worse, such approaches are ineffective. It is almost impossible to deal with the strategic (macro) issues that are the purview of senior administrators and board members by focusing on the tactical (micro) decisions that are the legitimate domain of unit heads.

Better that leaders focus on the *nature* of the budget and the priorities of clients.

The Strategic Budget

Institutional leaders cannot use the budget effectively as a tool for achieving their strategic plans and priorities if they do not participate proactively and appropriately in establishing the guidelines

that govern the budget-building process. Unfortunately, the involvement of senior administrators and board members in establishing the parameters that shape the budget is minimal or focused on the wrong set of questions.

In most public institutions, leaders tends to focus on (1) revenue estimation, with particular attention to tuition, enrollment projections, and the strategy for developing the state appropriation request; and (2) parameters for changes in "price" of certain line items, emphasizing salary increases, benefit packages, utility costs, and the operating budget. After deciding on these guidelines, senior administrators and board members typically retire to the sidelines while the budget is constructed from the bottom up. They reenter the process when a proposed budget is presented to them for review and approval. Interim activities more likely focus on resource acquisition—with advocacy to state government being the primary task—and not resource allocation.

Certainly, this scenario overemphasizes the distance between policy makers and key budget decisions, but not by much. Two key points are important. First, the initial guidelines address only issues of size and resource prices; topics that are the unique responsibility of institutional policy makers are excluded. They provide for neither asset maintenance nor innovation. Second, there is little likelihood that attention to institutional needs and priorities will emerge from the bottom-up process that follows. Unit heads have every incentive to look after their narrow interests, and almost no incentive to sacrifice those interests to support the priorities and agenda of the larger enterprise, which can be quite different. Since initial requests almost always are trimmed rather than expanded at subsequent stages in the process, funding requirements not incorporated at the first step are unlikely to gain serious consideration later. Interjecting additional demands into the budget when it is considered for final approval creates upheaval—normally too high a price to pay.

To expressly link institutionwide strategic objectives to the budget without getting entangled in details that rightfully are the domain of unit heads and mid-level managers, board members can devise a budget *structure* that has a strategic perspective. Also, establishing guidelines within this new framework can alleviate many deficiencies of the typical bottom-up approach to budgeting.

A Proposed Budget Structure. Budget structures of public institutions vary greatly, due to variations in the budgetary practices of state governments. To a large extent, these differences reflect a state-mandated requirement to base budgetary distinctions on *sources* of funds—hence a budget structure may have separate components for cash funds,

restricted funds, appropriated funds, general funds, and so forth. There tends to be more commonality among the states on the expenditure side, where categories such as "operating" budget and "capital" budget are most typical, and where, within the operating budget, categories such as instruction, academic support, student services, plant operation and maintenance, prevail.

While a step in the right direction, these distinctions do not sufficiently serve the needs of policy makers. The operating budget category typically makes no separate provision for strategic initiatives or innovations, and thus maintains the status quo. The capital portion usually is limited to physical assets (and often, only to buildings) and combines consideration of asset maintenance with asset creation. To better link the budget with strategic initiatives and the types of innovations policy makers seek, the budget structure should explicitly reflect the areas of responsibility of strategic-level decision makers, and the budget process should establish guidelines around each component of this structure as a prelude to initiating unit-level budget building.

A structure that would meet basic requirements would have the following components: strategic initiatives and innovation, contingency, asset maintenance, intended asset creation/deletion, and base/continuation budget (the status quo, adjusted for salary increases and price changes). These components are described below.

Strategic Initiatives. A strategic plan, if done well, identifies a small number of priorities—"institutional strategic themes"—in which change or improvement is desired within the institution or system. These should be problems or opportunities that cannot be addressed properly in one year and to which most, if not all, units of the institution can respond. Most institutions, but fewer systems, do a reasonable job of identifying these strategic priorities. Typically, they include improving undergraduate retention, especially for minority students; graduating students with better basic and higher order skills—communication, computation, problem-solving, and so forth; providing better services (training, applied research) to employers in the service area; improving transfer rates to four-year institutions (for community colleges); services to place-bound adults in remote areas of the state (if a system); and developing community partnerships. Once the planning is done and implementation begins, however, the process tends to falter. Departments are exhorted to address the priority issues, but they have little incentive to do so.

A strategic budget structure sets aside a pool of resources each year for the individuals and units that make the most positive contribution to addressing the strategic topics. The resources needed to

unleash a good deal of energy around these priorities are not great: From 1 percent to 2 percent of the base budget usually will suffice. And the mechanisms for distributing those resources can vary greatly, although competitive or performance-based approaches generally are best. The following are critical points:

- A pool of resources to foster change and improvement should be a part of the budget every year. No institution is in a position where everything it does is more important than the most creative response to an institutionally defined priority. This part of the budget should be no more subject to reduction in difficult economic times than the institution's base budget.
- These resources should be allocated on the basis of merit, not fair shares.
- The funds should be discretionary. The fewer the strings, the greater the value to recipients and the more recipients will compete for them.

In the absence of such "incentive funds"—and mechanisms for allocating them—it is unlikely the objectives from a strategic planning process ever will be accomplished.

The Contingency Fund. While it is hard to argue against the rationale for a contingency fund within the budget, there are several practical problems associated with its implementation. First, everyone associated with the budget-building process will argue against setting aside funds to deal with problems that *might* arise, when, by so doing, the institution will deprive units of needed funds and ensure that a different set of problems *will* arise. The counter argument is that budget decisions should be made concurrently when choices can be considered in the institutional context; it is contrary to the long-term interests of the institution to have major decisions about resource allocation forced in the middle of the year when choices are limited.

Second, contingency funds, once established, too frequently are considered "slush funds," rather than as an insurance policy against financial emergency. This perception worsens as senior administrators use the funds to grease the squeaky wheel and buy political favors within the institution. To protect against such behavior, boards should insist that when the contingency fund is used, it must be replenished in the subsequent year.

In some states, the largest impediment to creating a contingency fund is legislative history, policy, or statute. For example, funds may not be carried over from one fiscal year to the next. This creates an incentive not to have such a fund—or to spend it all every year and then fight to reestablish it. More insidious are the states that

"raid" such funds and take them back when the state budget is in trouble under the guise that "the institutions don't need the funds." The more enlightened states mandate the creation of contingency funds, typically in amounts of 3 percent to 5 percent.

Maintenance of Assets. The assets critical to the success of a college or university not only are physical assets such as buildings and equipment, but also curricula and human assets. If left unattended, all assets lose their value; in accounting terms, they depreciate. Buildings fall into disrepair, equipment becomes worn out or obsolete, curricula become outdated, and faculty members lose touch with advances in their field or new ways to teach.

While most policy makers recognize the importance of maintaining the assets they have worked so hard to acquire (although not all would consider human and curricular assets in this context), protecting the resources to pay for asset maintenance is perhaps the most difficult task in the budget-building process. Many factors make this so, including the structure of the state budget. Capital budgets typically are developed independently of operating budgets; in most states, the appropriation processes are separate as well. Since capital budgets often include renewal and renovation projects as well as new construction, the decision structure makes state government officials responsible for maintenance of institutional assets. These officials understandably place priority on building new facilities, not repairing old facilities, some of which bear the names of prior political leaders. Consequently, institutional administrators can, and usually do, absolve themselves of responsibility for the accumulation of deferred maintenance on the physical plant with this oft-voiced refrain: "We told the legislators how much we needed in order to remedy our deferred maintenance problems; it's not out fault they didn't appropriate sufficient funds."

A second factor is the political difficulty of explicitly investing in professional development of faculty and staff or in curriculum revision and reform. Both require faculty to get *out* of the classroom periodically and devote their energies to something other than teaching. At a time when legislators and the public insist faculty spend more time in the classroom—when sabbaticals are viewed as costly perks and released time devoted to curriculum revisions is assumed to be but another excuse to avoid teaching—developing resource allocation procedures that ensure the maintenance of *all* the critical assets of the institution is a difficult task, economically and politically.

Finally, asset maintenance usually is not a high priority among unit heads who initiate the budget-building process in a bottom-up system. They place a priority on protecting and adding faculty and

obtaining sufficient operating funds to meet their needs. They rightly believe maintenance of facilities is outside their purview and is someone else's responsibility. While they believe maintenance of curricular and human assets is important, they will trade off such uses of resources in a minute if they feel it threatens the status quo—change work load requirements, limit the pool for raises, and so forth.

In spite of the difficulties, institutional leaders must assume responsibility for maintaining the worth of the assets entrusted to their care. Philosophically and practically, they have to position the institution to effectively *expensing depreciation* of the key assets of the enterprise and annually reinvest this amount in these assets. If such a policy were fully operational in an institution, it would mean the following:

- An amount equaling 2 percent to 3 percent of the replacement value of the plant would be expended on facilities renewal and renovation each year.
- An amount equaling 10 percent to 15 percent of the book value of equipment would be devoted to equipment replacement annually.
- An explicit allocation of resources—largely in the form of faculty and staff effort—would be made to professional and curricular development each year. There is no conventional wisdom as to how much of an allocation of this type is appropriate. An amount equaling 5 percent to 10 percent might be considered initially.

Here is where board members can make one of their largest contributions to the long-term well being of the institution. By requiring a budget structured in a way that expressly recognizes asset maintenance and by establishing guidelines around this purpose before the bottom-up process begins, board members can help balance the long-term needs of the institution against the short-term interests that normally prevail. This is an area in which a clear statement of intent—and visible support for the institutional leadership in implementing these directives—is critical.

Asset Additions/Deletions. This piece of the budget is straightforward and represents the device by which institutional policy makers can signal initially their desires to change the asset structure of the institution—to invest more in equipment than would be called for in replacement, to add or eliminate staff positions, and so forth—and to keep track of the changes that emerge over the course of the budget-building process. Both functions are important. Analyses conducted to inform the budget process may yield results that argue strongly for changing the asset structure/mix of the institution in any number of ways, the following being examples:

- to invest more in equipment/educational technology;
- to eliminate programs that are inefficient, ineffective, or not central to the institution's mission;
- to reduce the number of administrators and reallocate certain functions to the faculty;
- to reduce the number of faculty lines by a set amount;
- to become less (or more) dependent on part-time faculty;
- to invest more in library books—or to invest less in books and more on telecommunications links to information sources maintained elsewhere; and
- to seek funding for a new building.

Such a list of policy directives or preferences provides parameters for budget building. In the end, however, not all can be attained. Resource limitation and the need to make trade-offs will limit the extent to which these parameters will be achieved. Before the overall budget is approved, however, it is useful to refer to this component to get a snapshot of how the resulting budget will change the asset structure of the institution. Will positions be eliminated? If so, what kinds of positions? Will desired investments in equipment and library books be made? This snapshot of the changing structure of the institution's assets, rather than details about the myriad ways these assets eventually will be used, represents a major focal point for policy-level decision making.

Base/Continuation Budget. This is the part of the budget that normally is considered *the* budget and is by far the largest component of any institution's fiscal plan. All other components are truly adjustments at the margin. They may be critical adjustments and legitimate focal points of the bulk of the budgetary discussion, but it is hard to conceive of a circumstance in which the sum of all other components would approximate even a quarter of an institution's base budget.

The decisions made prior to building this component are the ones with which policy makers are most familiar. They include levels of salary increase, supplies, and travel and estimated costs for utilities, insurance, and other centrally purchased goods and services.

Under the concept of strategic budgeting, the base budget eventually is developed in an entirely different way. It must be constructed after guidelines for the other components are established—in effect, starting the process by taking certain items "off the top." Consequently, more energy will go into allocating resources from a preestablished pool (for equipment, for example), rather than into deciding about such items at every step up the chain and discovering the net effect is not desirable or even acceptable.

A Summary Perspective

Figure 2 below summarizes the set of components and parameters that have been described:

- Revenues must equal expenditures—and reserves can be viewed as either a *source* of revenue or a *use* of revenue.
- Explicit allotments should be made for innovations and for contingencies.
- Expenditures for asset maintenance must be identified.
- There are many ways to balance the overall budget: affecting numbers of assets, their quality, their levels of utilization (such as work load), their prices, and the extent to which the institution opts to purchase a service rather than maintain its own assets (for example, contracting for food or custodial services).

Certainly, there is nothing easy about building a budget in these difficult and uncertain times. However, the right questions can be raised in the process.

Figure 2
An Overview of Strategic Budgeting Decisions

	Quantity	Quality	Utilization	Unit Cost	Total Cost		Total Rev.	Revenue Sources
Assets								Tuition
Personnel								Appropriations
Facilities								Govt. Grants
Equipment								Private Gifts
Collections								Endowment
Students						=		Sales/Services
Finances								Other Reserves
Program								
Consumables								
Services								
Supplies								
Utilities								
Contingency								
New Initiatives								

The Board's Role

The board of trustees must play a key role in the resource-allocation process if it is to use the budget as a tool for maintaining the long-term strength of the institution and for encouraging improvement and change in agreed-upon areas. In broad terms, this role involves setting expectations for, approving, advocating, and monitoring the budget.

Setting Expectations. Specifically, this includes the following:

- Requiring that the budget deal explicitly with each of the components described in this paper—change and innovation, contingencies, and maintenance and creation of institutional assets, as well as funding the status quo.
- Ensuring the establishment of appropriate target levels for funding in each of these areas, prior to the beginning of the bottom-up part of the process.
- Ensuring that strategic priorities—those to which change/innovation funds will be allocated—are stated clearly, and the mechanisms for soliciting funding requests in this arena reward merit, not fair shares. In addition, determining the measures to be used in monitoring progress.
- Approving the administration's plans for changing the asset structure of the institution—not necessarily in detail, but so the directions of change are appropriate.

The board must stand behind its judgments. These steps will make it increasingly difficult for an institution to maintain the status quo. The necessity for change will, initially at least, create conflict. The board should help senior administrators effect the right amount of change—and stand with them in the process.

Approving the Budget. Almost all boards must approve the budget formally prior to the beginning of the fiscal year. Before granting approval, however, board members should ask a series of questions, based on the budget components discussed earlier:

1. How much has been set aside for strategic initiatives (what proportion of the base budget), and how will these funds be allocated?
2. How large a contingency fund has been established?
3. Are sufficient funds allocated for the maintenance of assets?
   - What is the relationship between the proposed expenditures on renovation and renewal of the physical plant and the replacement value of that plant?
   - What is the relationship between proposed expenditures

on equipment and the book value of equipment?
- How much is being set aside for professional and curriculum development? What proportion of faculty effort will be devoted to these ends?

4. What will be the net effect of this budget on the overall asset structure of the institution?
- Will there be more or fewer employees? Of what kinds?
- Will programs be added or dropped? Which ones?
- Will the institution be investing more in equipment than the amount needed to maintain the status quo?
- Will the rate of acquisition of books and periodicals increase or decrease? By how much?

5. How will financial reserves change because of this budget?
6. What assumptions were made in developing the revenue part of the budget?
- What assumptions were made in developing enrollment changes, tuition levels, state appropriations, and gift revenues?

Board members should postpone action until they receive acceptable answers to these questions.

Advocating the Budget. The board's role in advocating the budget varies considerably among states. In many states, the board plays an active role in promoting the budget; ties to governors and legislative leaders make board members particularly effective in carrying out this function. In other states, this task is left to senior administrators who can work through the details of the budget with legislative staff and committee members.

There is one arena, however, where all board members should advocate strongly. They should work to ensure that state government creates an environment in which the board can create a strategic budget. This means institutions should be (1) allowed—even required—to maintain a contingency fund; (2) funded so they are responsible for asset maintenance; (3) allowed—even expected—to treat faculty, staff, and curricula as assets and to invest appropriate amounts in their continued development; (4) allowed to manage their resources more effectively—receive funds in a lump sum on broad categories (or more funds between categories much more freely), contract out certain functions, be freer of state personnel and purchasing regulations, and carry funds over from one fiscal year to the next; and (5) protected against legislative and executive branch "raids" on contingency funds established within agreed-upon guidelines.

Monitoring. The board should revisit strategic-budgeting questions and monitor their implementation at least quarterly. In addition, the

board should request annual reports on the progress of their plan and the achievement of the institution's strategic priorities.

Some Concluding Thoughts

This paper prescribes a significant change in the budgeting practices of most public colleges and universities. In many ways, it makes the jobs of board members more difficult. It requires them to be explicit about numerous factors that shape the future of the institution. It often is easier to let such requirements remain unstated; then policy makers can back away from them more easily when difficult choices must be made; however, such equivocation seldom leads to good decisions. The strategic budgeting process, though difficult, is a tool that will make board members more effective. By focusing their attention clearly on strategic and policy issues, board members will not be accused of micromanaging the institution.

Also, this strategic approach to budgeting engages the board as a whole, not just the budget or finance committees. The facilities committee helps shape the allocation of funds for renovation and renewal of plant. The planning committee considers that portion of the budget set aside for funding strategic initiatives. And the academic affairs committee helps oversee the process for faculty and curricular renewal. This gives the budget the potential for being an integrating force in a way seldom found.

Finally, the concepts in this paper work equally for system boards, with only one significant variation: There should be allowance for *two* levels of innovation. Each campus should be expected to identify its priorities and set aside funds to pursue these ends. At the same time, there should be funds *available at the system level* to support systemwide planning initiatives. Again, the mechanism should reward merit and accomplishment, not an "equitable" allocation of resources.

About the Author

Dennis P. Jones is president of the National Center for Higher Education Management Systems, a research and development center in Boulder, Colo., founded to improve the management effectiveness of colleges and universities. A staff member since 1969, Jones is widely recognized for his work in such areas as:

- state and institutional approaches to budgeting and resources allocation,
- strategic planning,
- educational needs assessment,
- faculty work load and productivity, and
- information for strategic decision making and the development of educational indicators.

Jones has written many monographs on these topics; has presented his work at regional, national, and international conferences; and has consulted with hundreds of institutions and state higher educaiton agencies on management issues of all kinds.

Prior to joining NCHEMS, he served as an administrator in business and institutional planning at Rensselaer Polytechnic Institute in New York. He received his graduate and undergraduate degrees from RPI in the field of engineering management.

The AGB Occasional Paper Series

1. **Emerging Policy Issues for Community Colleges**
   By Louis W. Bender
2. **Emerging Policy Issues for State Coordinating Boards**
   By Patrick M. Callan
3. **Emerging Policy Issues for Public Multicampus Systems**
   By Aims C. McGuinness Jr.
4. **Emerging Policy Issues for Foundations of Public Institutions**
   By Royster C. Hedgepeth
5. **Emerging Policy Issues for Single-Campus Public Institutions**
   By Kenneth P. Mortimer
6. **Emerging Policy Issues for Historically Black Institutions**
   By Alan H. Kirschner
7. **Emerging Policy Issues for Theological Schools and Seminaries**
   By Christa R. Klein
8. **Emerging Policy Issues for Church-Related Institutions**
   By The Reverend William McInnes
9. **Emerging Policy Issues for Private Research Universities**
   By Roger L. Geiger
10. **Emerging Policy Issues for Liberal Arts Colleges**
    By Kathryn Mohrman
11. **Information Systems for Board of Theological Seminaries**
    By Lawrence M. Butler
12. **Achieving Integrity in Intercollegiate Athletics**
    By Wilford S. Bailey
13. **Policies for Improving Trustee Selection in the Public Sector**
    By Patrick M. Callan and Dean A. Honetschlager
14. **Emerging Issues in Independent School (K-12) Governance**
    By Pearl R. Kane
15. **Tuition and Finance Issues for Public Institutions**
    By Thomas P. Wallace, Darryl J. Greer, and James R. Mingle
16. **Issues of Athletic Certification for NCAA Division I Members**
    By Maureen E. Devlin
17. **Long-Term Tuition Policy: What Happens When Tuition Rises Faster Than Ability to Pay?**
    By John A. Dunn Jr.
18. **"New Partnering" for Higher Education and the Corporate Sector**
    By Delwin A. Roy
19. **Board Effectiveness in Theological Schools**
    By Barbara E. Taylor and Christa R. Klein
20. **A Prescription for Vitality for Small, Private Colleges**
    By Ruth B. Cowan
21. **Strategic and Operational Reform in Public Higher Education: A Mandate for Change**
    By Robert C. Shirley
22. **Higher Education: On a Collision Course With New Realities**
    By David W. Breneman
23. **Results of a National Survey of Theological School Board Characteristics, Policies, and Practices**
    By Merrill P. Schwartz
24. **Integrating Endowment and Budget Planning**
    By Myron P. Curzan and Louis H. Katz
25. **The "Local Board" in Multicampus Systems and Universities**
    By Edgar B. Schick
26. **The New Activism of Corporate Boards and the Implications for Campus Governance**
    By Richard P. Chait
27. **Reducing Student Costs and Enhancing Student Learning**
    By Alan E. Guskin
28. **Strategic Budgeting: The Board's Role in Public Colleges and Universities**
    By Dennis P. Jones

Individuals affiliated with AGB-member institutions may photocopy and distribute copies of this paper. If you would like additional copies bound in this format, please use this order form or call AGB Publications at 202/296-8400.

Each copy costs $4.95 ($3.95 each for 10 or more). For orders more than $10 but less than $29, please add $3 for shipping and handling. For orders $30-$49, please add $5. For orders $50-$100, add $7. For orders less than $10 or larger than $100, we ship for free.

Paper number in series	How many copies?	Cost
	Shipping	
	Total	

Name _____

Address _____

_____

City, State, Zip _____

Phone _____

Mail to AGB Publications, One Dupont Circle, Suite 400, Washington, D.C. 20036. Questions? Call 202/296-8400.

ORDERS FOR LESS THAN $25 MUST BE PREPAID. If your order totals $25 or more, we can bill you. Simply mail this form to AGB or fax it to 202-223-7053.